This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

Volume Title: The State of Monetary Economics

Volume Author/Editor: Universities-National Bureau

Volume Publisher: UMI

Volume ISBN: 0-87014-307-7

Volume URL: http://www.nber.org/books/univ65-1

Publication Date: 1965

Chapter Title: Panel on Monetary Objectives, Potentialities, and Achievements Objectives, Monetary Standards, and Potentialities

Chapter Author: Harry Johnson

Chapter URL: http://www.nber.org/chapters/c5184

Chapter pages in book: (p. 137 - 146)

OBJECTIVES, MONETARY STANDARDS, AND POTENTIALITIES

Harry G. Johnson, *University of Chicago*

THE report of the Commission on Money and Credit [8] deals, in Chapter 2 on "National Economic Goals," with the objectives of policy. The main staff papers relevant to that chapter are those by Chandler [1], Klein [4], and the Scitovskys [6]. The same chapter deals in a general way with potentialities — the extent to which the goals are likely to be achieved in future. A full assessment of the potentialities, however, requires evaluation of the effectiveness of the instruments of policy and the efficiency with which they can be or are likely to be used, and raises in particular the questions concerning recognition, administration, and operation lags to which this morning's panel was devoted. The report does not face these issues squarely: Chapter 9, on "The Choice and Combination of Policy Instruments," by-passes the critical problem of economic diagnosis, confines itself largely to platitudinous or semitautological observations on how policy instruments should be used, and in its final conclusion that "aggressive, imaginative, and integrated use of our instruments of stabilization policy is necessary within a framework appropriate to a healthy growing economy" [8, p. 258] falls back in effect on the hope that if the economic authorities behave like good Americans all will be well. Nor does the report discuss the question of the monetary standard within the context of objectives and potentialities. Instead, apart from passing references to the need to avoid inflation for balance-of-payments reasons, it deals with objectives in isolation from the problems of international equilibrium associated with the fixed dollar price of gold, reserving these problems and their solution for discussion in a separate chapter (Chapter 8, "International Monetary Relations"). The separation of domestic from international policy problems is a crucial weakness in the report, and conceals serious possible conflicts between policy objectives.

It is instructive at the outset to notice two broad differences between the treatment of objectives contained in the C.M.C. Report and that to be found in the report of the Radcliffe Committee [7]. The first is that the Radcliffe Report lists four major general objectives of policy — a high and stable level of employment, reasonable stability in the value of money, economic growth, and stability of the exchange rate; the C.M.C. Report lists only three — "reasonable price stability," "low levels of unemployment," and "an adequate rate of economic growth"; and the omitted objective, given the Commission's strong endorsement of the present dollar value of gold, is balance in the balance of payments. The second, closely related difference is that the Radcliffe Report is much more explicit about the possibility of conflict between the policy objectives it distinguishes, and the need for the conflict to be resolved by compromise. The C.M.C. Report (and to a greater extent the staff papers, notably the Scitovsky paper) does recognize the possibility of conflict, but it devotes its major efforts to the contention that its three objectives are compatible with one another; and where it does recognize a clearcut possibility of conflict — between price stability and low unemployment — it dodges the issue by relying on the pious hope that other policies designed to improve the competitiveness of the economy, or enlist the economic statesmanship of union and business leaders, will permit the conflict to be resolved.

The omission of external balance as a policy objective, and the relegation of discussion of how to achieve it to a separate chapter on "International Monetary Relations," both falsifies the true nature of the objectives of U.S. economic policy and conceals serious possibilities of conflict between objectives. The present International Monetary Fund system attempts to operate a regime of fixed but infrequently alterable exchange rates with an inadequate, and inadequately growing, stock of international reserves. The United States plays a dangerously vulnerable role in that system, in view both of its large capital outflow commitments and of its assumption of the functions of a reserve currency country. In affirming that "the present dollar price of gold should be retained as the central pivot in the exchange rates structure among IMF member countries" [8, p. 231], the report is, first, virtually guaranteeing the continuation of chronic problems of international liquidity, and second, ensuring continuing problems of serious conflict between the objectives of U.S. policy.

The arguments for and against the present international monetary system are too intricate a subject to enter upon here. I would, however, venture the comment that American thinking on this subject, like British, is prone to exaggerate both the value of the commercial profits derived from conducting an international banking business, and the political and economic advantages of being a middleman for the investment of other countries' savings, as well as the moral virtue of assuming the responsibilities of reserve currency country. But it is prone to underrate the restrictions on the freedom of domestic policy that the reserve currency role entails. Be that as it may, insistence on maintaining the present price of gold leaves the United States three alternative methods of balancing its international accounts. One is to persuade other countries to undertake the adjustments required to preserve international equilibrium, by adjusting their domestic price levels or exchange rates to the U.S. gold price level, and by pursuing appropriate international lending policies. This solution is implied by the Commission's remarks on multilateral policies for adjustment [8, pp. 230–31]; but given the jealousies to which the assumption of world leadership inevitably gives rise, together with the moral judgments that now enter so largely into the discussion of exchange rate changes, this alternative is likely to be a dangerous (and humiliating) one to depend on. The second alternative is to rely on domestic policy measures to adjust domestic prices and incomes to the requirements of international balance. It must be emphasized that, contrary to the implication of various scattered remarks in Chapter 2 and elsewhere in the C.M.C. Report, this is not simply a matter of maintaining price stability. To combine low unemployment with balance-of-payments equilibrium may require sharp changes in the gold price level in either direction, depending on trends in the levels of income and prices prevailing in the rest of the world; and there is no reason for expecting that a high rate of growth alone will keep a country sufficiently competitive internationally (in terms of nonprice characteristics of its products) to enable its international payments to be balanced at a stable price level. The price behavior required to preserve balance-of-payments equilibrium for an economy growing at a high level of employment depends in a complex way on the nature and rate of growth in that country and elsewhere, and on the others' price trends. It cannot be summarized in the simple prescription of price stability; to assume that it can amounts to assuming that the balance of payments will somehow be looked after in another way.

The Commission rejects the policy of maintaining external balance by the methods of general economic control, on the grounds that "the costs in terms of unemployment and lower growth would be so great from trying to correct our balance of payments deficit by general monetary and fiscal policies that alternative means should be sought to achieve the necessary balance" [8, p. 227]. This leaves the third alternative, which comprises a variety of selective interferences with trade and payments, and devices to insulate domestic from international policy. The analysis of the report makes considerable use of two suggested insulatory devices, each questionable though on different grounds. One is that debt management and monetary policy can be used to keep short rates high to discourage capital outflows, while keeping long rates low to encourage growth. Theoretical reasoning and empirical research and experience raise serious doubts that much can be achieved along these lines. The other is that, by using deficit financing rather than monetary expansion to promote high employment, long rates can be kept high enough to deter capital outflows. This notion, besides raising the question of the political practicability of deficit financing, tends to overlook possible adverse consequences upon attainment of the objective of growth. Apart from these considerations, the report seems to me to attach quite inadequate weight to the seriousness of the balance-of-payments problem, and to take far too sanguine a view of the extent to which the problem can be solved by various forms of tinkering which will not seriously conflict with the main objectives of domestic policy, including the vacuously-stated objective of "a desirable degree of economic freedom and reliance on the market mechanism for the allocation of products and resources" [8, p. 9].

The report, like national policy in the past few years, is grasping at expedients rather than facing the problem squarely — which means, fundamentally, taking a really hard look at the implications of the fixed exchange rate system. The danger of this procedure inheres in the fact that, regardless of how firmly asserted the principle is that the balance-of-payments problem must be solved without sacrificing the domestic objectives of employment and growth, international balance is the one objective of policy the necessity of whose achievement is imposed on the policy makers by strictly economic considerations, and whose nonachievement calls economic pressures into play which ultimately force the policy makers to act. The other three objectives — price stability, low unemployment, and growth — are essentially politically-imposed objectives, the sanctions for which are applied remotely, through the ballot box; and in the case of growth, the effects of failure to grow rapidly impinge on the voter's consciousness so remotely that the objective can scarcely be said to have any direct political force behind it. The serious danger is that through a combination of refusal to face the conflict between external balance and internal objectives, a preference for palliative tinkering in external economic relations, and the steady restrictive pressure of external disequilibrium on policies of domestic expansion, the country will drift into the worst possible situation, one of chronic balance-of-payments weakness combined with higher average unemployment and slow growth. Even worse is the danger that, in the process of drifting, the employment and growth objectives will be so watered down, and the price-level objective so reinforced by the balance-of-payments problem, that the levels of employment and growth actually attained will appear as the maximums objectively feasible. There are, unfortunately, already plenty of signs in official thinking and pronouncements of this process of adjustment of domestic objectives to the balance-of-payments restriction.

In summary, given the Commission's endorsement of the gold standard, its failure to include external balance among the objectives of policy is a major weakness in its analysis; alternatively, the Commission ought to have carried its emphasis on the primacy of domestic objectives to the point of being prepared to contemplate a change in the price of gold, or the abandonment of a fixed gold price for the dollar. Admittedly a unilateral change of this kind would involve a serious disruption of the present international monetary system; this is all the more reason for giving careful preparatory thought to how such disruption could be minimized.

To turn to the three goals of national economic policy the report does discuss, Klein's introductory remarks on economists' fads [4, pp. 1–4] are extremely pertinent in putting these goals in historical perspective. Klein points to the danger of overgeneralizing from a brief period of historical experience. The three goals of low unemployment, reasonable price stability, and adequate rate of growth are all derived from recent brief historical experiences: low unemployment as a goal derives from the 1930's, price stability and growth from the late 1950's. Of the two recently added goals, it seems fair to observe that price stability is a goal generated by public opinion, to which economists have responded by producing ceremonially adequate theories of chronic inflation; whereas adequate growth is much more a creation of the profession itself, a reflection of the extent to which growth has become the test of efficient economic performance under the combined influence of the cold war and concern with the underdeveloped countries. Growth, as such, is not self-evidently an object of policy in a free enterprise economy; and the recent emphasis on the desirability of a high rate of growth seems to me to involve grafting on to a free enterprise system standards appropriate to a planned economy with military and political ambitions. I am not arguing that U.S. foreign policy may not require the support of a high domestic rate of growth, but simply that to pretend that it is a strictly economic goal can only confuse the issue. (In this respect the report is less honest than the staff papers, in failing to mention the political motivation for growth.) Nor would I dispute the quite different proposition that there are many high-yielding investments in such things as education and basic research that private enterprise will not undertake, and whose undertaking by the state will result in faster growth.

The "faddy" aspects of the goals of price stability and growth are well illustrated by some features of the report's discussion of them. With respect to price stability, the report begins by conjuring up the horrors of hyperinflation; though it admits that hyperinflation is not a real threat in the United States, and that arbitrary redistribution of income and wealth is far less drastic in a mild inflation, it nevertheless sets the avoidance of even mild sustained increases in the price level as a major goal. In so doing it ignores the now large body of empirical evidence to the effect that the arbitrary redistributions it abhors are difficult to detect in mild inflations, and the theoretical analysis indicating that economic behavior will adjust to inflation. It ignores also the fact that it mentions later that the upward bias in existing price indexes makes it very difficult to be sure that the upward movement of the indexes since 1953 represents genuine inflation. It is difficult to avoid the conclusion that the Commission has been guided by the a priori conviction that inflation is a terrible evil. With respect to growth, "faddiness" is evidenced in the Commission's expressed belief that the rate of growth has been inadequate, coupled with its inability to explain why it thinks so and its unwillingness to state a target rate of growth. (The report's only positive statement on this subject — "A growth rate below that which is obtainable in an economy operating at a high level of employment of our human and physical resources and at reasonably stable price levels is clearly not adequate" [8, p. 37] — is a masterpiece of high-sounding emptiness, quite apart from the ambiguity of the word "obtainable;" it amounts to saying that growth is not positively undesirable.

The goals themselves are not ultimate objectives clearly related to a consistent concept of national economic welfare but, instead, are proximate objectives defined in terms of the operating characteristics of the economy, whose relation to economic welfare is not necessarily very close or direct. Each goal is defined by a modifying adjective — "reasonable," "low," "adequate" — indicating approval of the relevant characteristics of the economy's performance, evidently by public opinion or some sector of it. Just what satisfactory performance amounts to precisely is discussed only in connection with low unemployment. Despite the noncomparability and imprecision of the goals, the report asserts that they are equally important. Just how importance is assessed is nowhere explained. The Commission clearly does not have any operational definition in mind; presumably it believes that all goals are equal, but these are more equal than others.

Definition of the goals of public policy in terms of popularly approved characteristics of economic performance is perhaps the only legitimate approach in a democratic society, especially for a body like the Commission not entrusted with actual policy making. But to be useful as a guide to intelligent policy making or policy evaluation, a statement of goals in these terms should be accompanied not merely by recognition of the possibility of conflict between objectives, but also by consideration of factors relevant to making the optimal compromise in cases of conflict. The report stops far short of being useful in this respect. First, while it recognizes the possibility of conflict, its main argument is devoted to proving the compatibility of objectives. The one conflict it recognizes as likely — between low unemployment and price stability — it evades by appealing to other policies, confidence in whose likely effectiveness is not justified by experience here and in other countries. (Incidentally, the report seems to me to gloss over another conflict in its discussion of growth and inflation. The statistical evidence it quotes — to the effect that there is no association between the growth rate and the rate of price change for rates of price increase between zero and 6 per cent, but that countries with prices changes outside these limits experience lower growth rates — implies that normally growth and moderate inflation go together, not that "there is no basis for believing that inflation is needed to stimulate growth" [8, p. 44].) Second, by confining the argument to the goals as defined by public opinion, the Commission deliberately evades confronting the problem of resolving conflict intelligently, and offers public opinion no guidance. The Commission regards the problem as one of "trading-off" one goal against the other; since the rate of price increase, the percentage of unemployment, and the growth rate are incommensurable, casting the problem in these terms fails even to call attention to the need for commensuration to resolve conflicts.

There are two possible approaches to efficient resolution of a conflict of objectives, both of which involve going behind the stated objectives to their economic content. I take the conflict between price stability and low unemployment as an example. One approach is to attempt to attach economic costs of a comparable kind to the nonfulfillment of objectives — say, the loss of income to the unemployed as against the loss of real income and property to the victims of inflation. The other is to investigate whether the social losses from nonfulfilment of an objective can be eliminated or mitigated by institutional changes — in the case of inflation, by indexing and other measures surveyed in Holzman's paper [3], in the case of unemployment, by more generous unemployment benefits as Galbraith suggested in *The Affluent Society* [2, chapter 21]. Either, or both in combination, would be likely to lead to a more socially efficient resolution of conflict than reliance on an undefined social welfare function containing the rate of price increase, the level of unemployment, and the rate of growth as arguments would be.

I have used the example of conflict between price stability and low unemployment for a particular reason: in spite of the Commission, the staff papers, and a widespread agreement among the profession, it does not seem to me that the rate of growth belongs in the group of objectives with the other two. Both the rate of price change and the amount of unemployment can, for purposes of broad analysis, be taken to depend on the level of aggregate demand, and so to be amenable to "monetary, credit and fiscal policies"; the fact that they vary in opposite directions with demand poses the crucial conflict of objectives. But the rate of growth is a question of the allocation of resources between current uses and output-increasing activity. The choice between fiscal and monetary policy may influence this allocation; but there is no a priori reason why, other things equal, the rate of growth should vary with the average level of unemployment. In particular, contrary to the belief of the Commission and many economists, there is no a priori reason for expecting a higher normal level of employment, accompanied presumably by a higher rate of price increase, to produce a higher rate of growth.

In analyzing this problem it is necessary to recall that the rate of growth measures the proportionate and not the absolute annual increment of output, and that one should exclude the transitory effects of changes in the percentage of unemployment. Put very crudely in terms of the Harrod-Domar equation, the problem is whether a higher level of employment and income will raise the average proportion of income saved, lower the marginal capital-output ratio, or (more realistically) raise the savings ratio sufficiently to offset a raised marginal capital-output ratio. Both theory and empirical knowledge about these relationships give little grounds for the confident affirmative answer that many economists are inclined to give, and that is echoed in the report.

The report's conclusion that "measures to stimulate aggregate demand to attain low levels of unemployment are basic to an adequate rate of economic growth" [8, p. 43] is derived by extremely questionable arguments. The report credits low unemployment with both the immediate increase in output consequent on reduced unemployment, and the longer-run (but still once-over) effect of lower unemployment on the size of the effective labor force. The only possibly permanent effect on the rate of growth of output it mentions is a decrease in the rate of reduction of hours of work, and this begs the question of the difference between real output and real income. The report recognizes that no firm conclusion can be reached concerning the effect of low unemployment or of the more appropriate measure of growth, the rate of growth of real GNP per man hour, but argues that special policies for increasing productivity can be introduced more easily when unemployment is low. This may be so: but the report loads the dice by assuming that demand is fixed and not increasing with productivity, so that increased productivity necessarily releases labor, and by arguing in terms of absolute rather than proportional increases in the productivity of the economy.

Similar objections can be raised against the Scitovskys' arguments [6] for high employment as a growth stimulator, which also rely on counting transitional effects. Using an average multiplier, the Scitovskys calculate the reduction in investment necessary to increase unemployment by 1 per cent, find that it amounts to 10 per cent of net domestic capital formation, and argue that this will reduce the rate of growth by 10 per cent [6, pp. 8–9]. Apart from its gross overexaggeration of the contribution of net capital formation to growth, this argument overlooks the effect of the reduction in demand on the denominator of the rate-of-growth equation.

In the same way, Klein's initial argument [4, p. 36] that, on the surface, growth and full employment are complements confuses the maximization of potential output at a point of time with increasing the growth rate. Klein goes on to a more sophisticated argument, on Harrod-Domar lines, to the effect that full employment has reduced the U.S. growth rate by encouraging high consumption [4, pp. 39–40]; but his attribution of the fall in the aggregate savings ratio to full employment is not convincing. Only Chandler [1, pp. 44–9] recognizes clearly that the rate of growth is a question of the composition of output, and that theory indicates no clear relation between it and the level of activity.

I conclude that it has yet to be demonstrated that lower unemployment as a normal situation (in contrast to a movement from higher to lower unemployment) is good for growth. Nor do the report and staff papers suggest any close relation between inflation and growth. It therefore seems that the report's treatment of price stability, low unemployment, and adequate growth as comparable policy objectives is a misclassification; that the objectives especially relevant to aggregative economic policy are price stability and employment, only; and that growth should be relegated to a position among the other objectives — economic freedom, defense, equitable distribution — that the Commission regards as desirable.

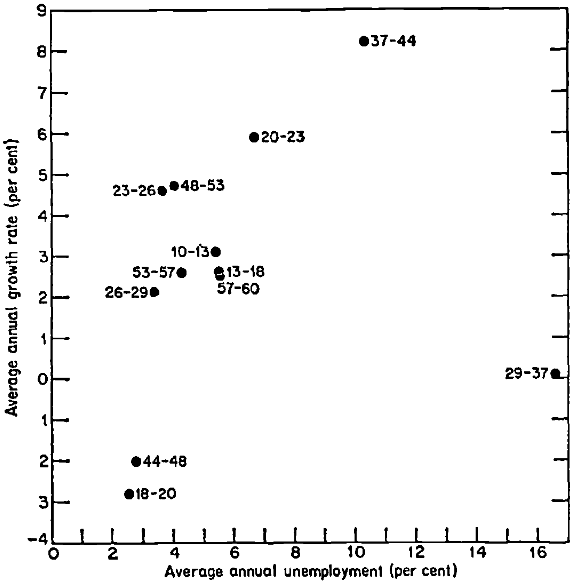
Though growth should not be ranked with price stability and low unemployment as an objective relevant to aggregative policy, growth policy might still be relevant to the attainment of these other objectives. The Commission, as already mentioned, looks to policies increasing competition and to economic statesmanship to resolve the apparent conflict between price stability and employment. An alternative policy (presumably what Klein recommends [4, pp. 42–3], though he does not spell out the logic adequately) would rely on the conscious promotion of increasing productivity to reconcile the rate of wage increase at low unemployment with price stability. The practicability of either solution seems doubtful: enforced competition and voluntary "economic statesmanship" are unlikely to be capable of overcoming a rate of price increase estimated to be of the order of 4 per cent at 4 per cent unemployment [5, p. 15]; and it is equally unlikely, even if the (Phillips) type of relation between unemployment and wage-rate change is reliable and independent of the rate of productivity increase, that the latter can be raised sufficiently by growth policy to achieve price stability. Thus the conflict between price stability and low unemployment is likely to persist. The economist is most likely to contribute fruitfully to its resolution by further study of how far the conflict is created by our methods of measurement of prices and unemployment, what the costs of alternative compromises are, and how far the social costs of nonfulfilment of objectives can be mitigated.

Appendix

This appendix presents some empirical evidence on the observed relationship between unemployment and growth rates.

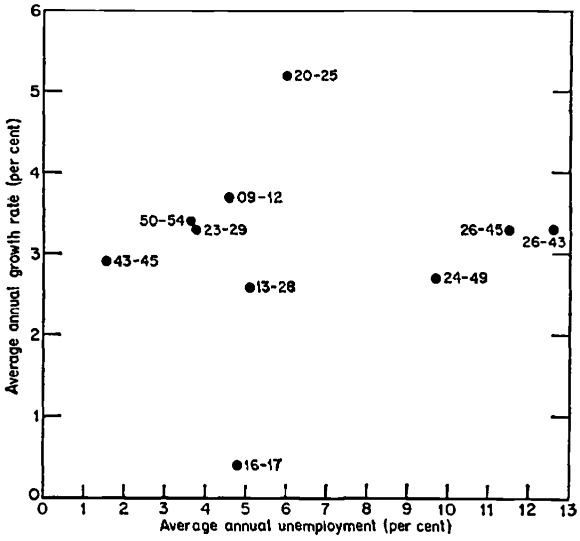
Chart 1 relates annual average growth rates of real GNP to average annual unemployment percentages for the United States, for peak-to-peak National Bureau reference cycles. If anything, the Chart shows a posi-

CHART 1. — ANNUAL AVERAGE GROWTH RATES AND ANNUAL AVERAGE UNEMPLOYMENT PERCENTAGES, PEAK-TO-PEAK REFERENCE CYCLES, UNITED STATES, 1910–60



SOURCE:
Cycle dates: NBER reference-cycle peaks.
Growth rates: Denison, *The Sources of Economic Growth in the United States* (C.E.D., 1962), p. 17.
Unemployment percentages: 1910–48, Stanley Lebergott, "Annual Estimates of Unemployment in the United States, 1900–50," in *The Measurement and Behavior of Unemployment*, Special Conference 8, Princeton for NBER, 1957, pp. 215–16; 1948–60, *The Economic Report of the President*, 1962, p. 230.

CHART 2. — ANNUAL AVERAGE GROWTH RATE OF REAL GNP AND ANNUAL AVERAGE PERCENTAGES OF UNEMPLOYMENT FOR PERIODS WITH EQUAL TERMINAL UNEMPLOYMENT RATES, UNITED STATES, 1909–49



SOURCE:
Growth rates: Denison, *Sources of Economic Growth*, p. 17.
Unemployment rates: Lebergott, "Annual Estimates of Unemployment," pp. 215–16.

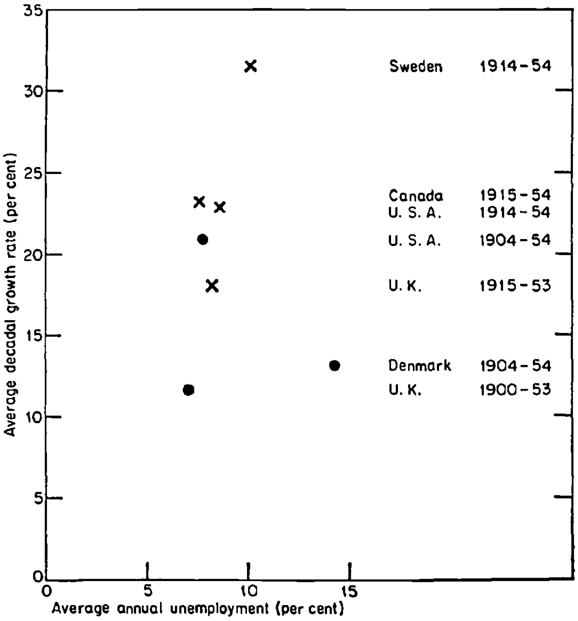
tive relationship between average unemployment and the growth rate: the location of the point for 1929–37, relative to the majority of the other points, and the relationship of the points for 1948–53, 1953–57, and 1957–60, suggest the contrary relationship, and may constitute the empirical basis of the view disputed in the paper, that high employment promotes growth.

The data in Chart 1 are undoubtedly distorted by the fact that successive cycle peaks are characterized by substantially different percentages of unemployment. Chart 2 relates annual average growth rates of real GNP to average annual unemployment for the United States, for periods for which the unemployment percentage was the same in the initial and final year.

Chart 3 relates Kuznets' long-run average decadal growth rates of production per capita in various countries to their average unemployment percentages.

None of these charts shows any definite clear-cut relationship between the growth rate and the unemployment rate. They therefore support the doubts expressed in the paper concerning the appropriateness of including growth with price stability and low unemployment as objectives of economic policy.

CHART 3. — INTERNATIONAL COMPARISON OF AVERAGE DECADAL GROWTH RATES OF PRODUCTION PER CAPITA, AND AVERAGE ANNUAL UNEMPLOYMENT PERCENTAGES



NOTE: All unemployment percentage averages end with 1950 — the terminal data of the Galenson-Zellner estimates — and start with the intitial year indicated except for Canada (initial year 1916).
SOURCE:
Growth rates: Simon Kuznets, "Quantitative Aspects of the Economic Growth of Nations, I. Levels and Variability of Rates of Growth," *Economic Development and Cultural Change*, Vol. V, No. 1, Oct. 1956, pp. 38–40.
Unemployment percentages: (Canada, Denmark, Sweden, United Kingdom): W. Galenson and A. Zellner, "International Comparison of Unemployment Rates," in *Measurement and Behavior of Unemployment*, pp. 455–56.
U.S.A.: Lebergott, "Annual Estimates of Unemployment," pp. 215–16.

REFERENCES

1. Lester V. Chandler, "Potentialities and Limitations of Monetary Policy," C.M.C. Staff Paper No. 218A.
2. J. K. Galbraith, *The Affluent Society*, London, Hanrish Hamilton, 1958.
3. Franklyn D. Holzman, "Mitigation of Inflation," C.M.C. Staff Paper No. 209E.
4. Laurence R. Klein, "Empirical Aspects of the Trade-Offs among Three Goals: High Level Employment, Price Stability and Economic Growth," C.M.C. Staff Paper No. 141E.
5. A. W. Phillips, "Employment, Inflation and Growth," *Economica*, N.S., Feb. 1962, pp. 1–16.
6. Tibor and Anne Scitovsky, "Welfare Aspects of Economic Growth, High Level Employment and Price Stability," C.M.C. Staff Paper No. 141E.
7. Committee on the Working of the Monetary System (Chairman: The Rt. Hon. the Lord Radcliffe, G.B.E.), *Report*, London, Her Majesty's Stationery Office, 1959.
8. Commission on Money and Credit, *Money and Credit: Their Influence on Jobs, Prices and Growth*, Englewood Cliffs, N.J., Prentice-Hall, 1961.

COMMENT

ABBA P. LERNER,
Michigan State University

Franco Modigliani's comments on the burden of the debt suggest to me that one must be especially careful with statements that are likely to be interpreted by the general public as saying something that is false, even if their esoteric meaning to those who can read the small print is beyond reproach. We all know the story of the traveling salesman who says to his rival, "You tell me you are going to Pinsk this week so that I should think you are going to Minsk, but you are really going to Pinsk, you liar!" I hope this example of how a true statement can mislead will not give the impression that I think that it is Modigliani's intention to deceive. But I do wish to point out that his statement that the national debt is a burden on future generations is almost certain to be interpreted as supporting the man-in-the-street's understanding of these words — an understanding that I am sure Modigliani would condemn as strongly as I would.

The man in the street thinks of the national debt as the debit entry on the government's ledger — the fact that the government *owes* it. His conception of the burden consists of concern about the existence of this debit item in analogy with concern about his own debts, and of concern about taxes that may be imposed to service the debt. His error lies in failing to see that from the social point of view the debit item, the existing debt of the government, is canceled by a credit item, the existing credit of the public, namely their ownership of the government debt certificates; and in failing to see that if any taxes should be imposed on future generations for servicing the debt they could only be used to make payments to members of the same generation living at the same time. Modigliani is perfectly clean of these primitive errors. His argument is an entirely different one. But in using the same words as the man in the street, he makes it easy for the latter to claim support and so he incurs some responsibility for the propagation of error — even if it is only in the manner of the man who contributes to the stealing of his car by leaving the key in the ignition.

Modigliani's concern is not at all about the *debit* item in the government's ledger, but only with the *credit* item in books of the owners of the government securities. His worry is not that the country is poorer because the government *owes* so much but that the public is richer because it *owns* so much in government paper. The government debt (read "private credit") is no burden. On the contrary it is a *boon*. The private wealth makes the public so much better off that they are induced to take out some of the benefit in better current living by saving less. The burden that Modigliani is concerned with is borne not by the future generations that inherit the national debt, or even by any future generations that may pay taxes to service it, but by generations in the further future that inherit less capital goods because of the high life enjoyed by those who inherited the debt. This burden would not be diminished if the national debt were magically dissolved (after the intermediate generations had had their good time) so that no taxes could be called for to service it. On the contrary, the generation thus magically relieved of the national debt would suffer doubly. It would find itself not only with less productive capital but also with less private (claims to) wealth.

Modigliani's burden arises essentially from an asymmetry that is the opposite of the one imagined by the man in the street. It is due to the awareness by the public of the credit side of the national debt-credit without any adequate awareness of the debit side which is on the books of the government. This is what makes them less thrifty. Being richer, they are in less need of savings.

There are a number of questions on the esoteric side, such as whether the same argument would not apply in similar or perhaps in greater measure to private debt incurred by corporations that are unable to finance growth out of profits, or whether there is not the same lack of offsetting private debt in the burgeoning of private wealth from the marking up of private speculative or "growth" stocks. (That the private investments may be socially productive is as irrelevant as the possibility that the government expenditures might have been socially productive.) But I cannot go into these questions here. I can only deplore Modigliani's having joined the recent fashion of irresponsibly clothing ingenious new theories in redefined old words so that they lend themselves to be paraded as rehabilitations of ancient fallacies.

In the matter of the treatment of national economic goals I find myself in close agreement with Harry Johnson, although it seems to me that the safety valve for prejudices and special interests provided by the footnotes in the Report of the Commission on Money and Credit save it from the more complete bogging down in compromises and platitudes that characterizes the Radcliffe report. I would put even more emphasis than he does on the failure to face up squarely to the balance-of-payments problem and the resorting to ineffective expedients because of an unwillingness to consider the possibility that it may be necessary to sacrifice the tie to gold — or rather the remnants of it that we have left. Such clinging to the memory of the international system that was the gold standard I have elsewhere called "sentimental internationalism." For it is unreasonable to suppose that changes in the conditions of international trade and capital movements will always be such as to protect our balance of payments and enable us to meet our costly and continuing foreign obligations for aid to allies and for economic development, or that the necessary adjustments could be achieved by the relative deflation of our wage and price levels. If we remain addicted to sentimental internationalism we will find ourselves in the position of the Jew who was told by the local tyrant that he could choose between eating a dish of stinking fish, receiving a hundred strokes of the whip, or paying a thousand ducats. The Jew said he would eat the fish but got so sick that he was unable to eat more than three quarters of it. He then said he would take the hundred strokes, but by the ninetieth he was near death, so he paid the thousand ducats.

If we fail to free ourselves from the fixed exchange rate we shall have to beg, borrow, or steal to cover the unfavorable balances we may incur. We have already suffered severely from our attempts to beg other countries to relieve us from some of our international obligations. We shall encounter similar difficulties if we keep on borrowing money, hot or cold, to cover deficiencies in our balance of payments. We shall then have to resort to "stealing." First, in the sense of engaging in "beggar my neighbor" restrictionist policies, until the relief is ended by retaliatory restrictions by the beggared neighbors (while the evils remain both for us and for them). Then, in the sense of beggaring ourselves by engineering sufficient depression in our own country (by fiscal or monetary measures) to induce the decrease in imports that would correct our balance of payments. Finally, there will be a domestic revolt against this "cross of gold" and we shall be forced to submit to the devaluation we tried to avoid by attempting to swallow the "stinking fish."

I would also agree with Harry Johnson's evaluation of concern with growth as a fad.

Raising the standard of living of the average American is certainly much less urgent even than the "secondary" objectives like freedom, defense, or equitable distribution.

The most important issue raised is the conflict between the remaining two primary objectives of monetary policy: a high level of employment and a stable price level. Harry Johnson suggests that we should concern ourselves not with finding the best trade off between unemployment and inflation but with mitigating the evils. I do not see why one should have to choose between mitigation and optimum trade off. Indeed it is only when the mitigation possibilities are fully exploited, and we have thus minimized the evils of the various degrees of unemployment and inflation, that we have the measures of the alternative evils to be traded off and can rationally approach the problem. Measures for increasing productivity are of course eminently desirable for obvious reasons, but it is not at all clear that they will help much in relieving the pressure for wages to increase more rapidly than productivity (with adjustments for conceivable changes in profit mark-up rates). This is partly because increases in productivity raise the sights for increases considered reasonable or legitimate, and partly because of the ratchet effect between (1) wage increases based on productivity in high productivity-gain industries, (2) wage increases based on equitable adjustments in low productivity-gain industries, and (3) wage increases based on price increases brought about by (2).

There thus remains the unavoidable necessity for deciding where to trade off unemployment against inflation. A 5 per cent per annum inflation means that a fraction of 5 per cent of the national income is unjustifiably shifted from some members of society to others. The total shift cannot be more than 5 per cent, while some of it goes in desirable directions and much of it is in opposite directions and cancels out. Certainly complete compensation of those harmed could not come to more than about 1 per cent of the national income, and even that would be not a net social loss but a transfer. A 5 per cent depression means the 5 per cent absolute loss of output that fails to be produced as a result of about 2 per cent of excess unemployment (i.e., above the 2 per cent that seems to be necessary for a free economy to be able to work). It would therefore seem that 1 per cent of excessive employment should be considered at least as bad as 5 per cent inflation. Yet the present policy in this country seems pretty clearly to be to accept all the unemployment that is necessary to achieve price stability, as if any degree of inflation is worse than any degree of depression.

It seems to me that President Kennedy's anger at the attempted increase in the price of steel was due to his having thought that he had bought price stability for 6 or 7 per cent unemployment and found that it had not stayed bought. It seems to me, too, that the widespread feeling that it was a good thing for the President to have stopped the steel price increase but that it was a bad thing for him to have used such a concentrated mobilization of executive powers and threats to achieve it, is an encouraging step in the direction of recognizing that the alternative to arbitrary authority is the rule of law; that only the development of rules for preventing such price and wages increases and for enforcing such prices decreases as would have been prevented or enforced by a competitive market can achieve the desired ends without calling for the undesired means; and that only when such regulation of wages and prices becomes politically possible will we be able to achieve both goals — a high level of employment and a stable price level.